

AMBIF Bond and Note Issuance: Relevant Features in the Philippines

In addition to market features corresponding to the AMBIF Elements, a number of general Philippine market features for bond and note issuance to professional investors (Qualified Buyers) need to be considered by market participants. These features are described in this chapter.

In choosing a location to issue bonds, cost is a major consideration. While the AMBIF Implementation Guidelines only refer to applicable fees and charges arising from bond and note issuance under AMBIF, the ASEAN+3 Bond Market Guide for the Philippines contains a comprehensive chapter with descriptions of the typical cost factors such as registration fees, listing fees, enrollment fees, documentary stamp taxes, and taxes on interest income. The ASEAN+3 Bond Market Guide for the Philippines also contains information on relevant taxation for debt securities.

A. Governing Law and Jurisdiction

Governing law and the jurisdiction for specific service provisions in relation to a bond or note issuance may have some relevance in the context of AMBIF. Potential issuers may consider issuing under the laws or jurisdiction of an economy or market other than the place of issuance. The choice of governing law or the contractual preferences of stakeholders can affect accessibility to a specific investor universe that may otherwise not be accessible if a bond or note were issued under the laws of the place of issuance. However, provisions related to bond or note issuance and settlement must be governed by the laws and regulations of the place of issuance since an AMBIF bond is a domestic bond.

The civil code of the Philippines permits the use of governing law or jurisdictions other than the Philippines in contracts, provided that such provisions do not contravene existing Philippine law.

Should the parties involved in a bond or note issuance choose to use Philippine law, the jurisdiction of the issuance would fall to Philippine courts by default. If anything other than Philippine law is chosen as the governing law in the transaction documents, the parties thereto may choose the specific jurisdiction of a court in which disputes will be adjudicated.

In the case of issuance of PHP-denominated bonds or notes in the Philippines, even in cases when contract parties choose a governing law other than Philippine law for the contract, it is expected that Philippine law would prevail as the law specific to issuance- and settlement-related matters.

Notwithstanding the above, Philippine courts and courts of other jurisdictions may have jurisdiction over disputes arising in relation to such bond issuances, to the extent permitted by Philippine or other relevant laws.

In any case, the actual use of governing laws or jurisdictions other than those of the Philippines may be subject to clarification or legal advice from a qualified law firm, as may be necessary.

B. Language of Documentation and Disclosure Items

It is envisaged that most ASEAN+3 markets participating in AMBIF will accept the use of a common document in English. However, some markets may require the submission of approval-related information in their prescribed format and in the local language. In such cases, concessions from the regulatory authorities for a submission of required information in English—in addition to the local language and formats—may be sought.

In the Philippines, an English translation shall be used in all documentation with regard to the issuance of bonds or notes.

C. Credit Rating

Bonds and notes to be listed or enrolled on PDEX require a credit rating in line with the credit rating requirements stipulated by the SEC and the BSP. This includes bank-issued bonds and commercial paper.

In its Memorandum Circular No. 7 released in March 2014, the SEC announced the Guidelines on the Accreditation, Operations, and Reporting of Credit Rating Agencies, which govern the two domestic CRAs—Philippine Rating Services (PhilRatings) and Credit Rating and Investors Services Philippines—and clarify the acceptance of credit ratings from international CRAs. The guidelines on accreditation are now included in SRC Rule 39.1.5.

BSP-supervised financial institutions can source capital through the issuance of “unsecured subordinated debt,” which can be used as Tier 2 capital. Issuing this type of debt to the public requires a rating from a recognized CRA.

PhilRatings was the first domestic CRA to be recognized by the BSP, based on minimum eligibility criteria for bank supervisory purposes. The BSP also recognizes the credit ratings of internationally accepted CRAs—such as Fitch Ratings, Moody’s, and Standard & Poor’s, as well as Fitch Singapore—for bank supervisory purposes. PDEX accepts the credit rating of the issuer or issue from a CRA duly recognized by the applicable regulatory authorities.

Unrated bonds and notes are possible under present regulations and may be listed on the PDEX Qualified Board. However, it has been observed that potential AMBIF investors may prefer that bonds and notes have a credit rating.

D. Selling and Transfer Restrictions

Selling and transfer restrictions for the issuance of bonds or notes to professional investors are well defined in the identified professional market segment in the Philippines (Qualified Buyers and Qualified Securities).

Pursuant to Sections 9 and 10 of the SRC, the IRR published by the SEC prescribe a template and specific provisions on the use of that template, and define the selling and/or transfer restrictions when issuing bonds or notes to Qualified Buyers.

To further ensure the validity of an exemption claimed by an issuer under Section 10.1 of the SRC when issuing bonds or notes aimed at Qualified Buyers, the SEC also looks to the underwriter—licensed by the SEC—to observe the applicable provisions and selling and transfer restrictions under the law.

In all offer documents and related correspondence to Qualified Buyers, including the term sheet of a proposed bond or note issue, an issuer must make explicit reference to Section 10.1 (l) of the SRC and give their commitment that said offer is limited to Qualified Buyers, thereby constituting an Exempt Transaction under the law. The IRR related to Section 10.1 (1.c) of the SRC prescribe the following statement in bold face and prominent type:

The securities being offered or sold have not been registered with the Securities and Exchange Commission under the Securities Regulation Code, any future offer or sale thereof is subject to registration requirements under the Code unless such offer or sale qualifies as an Exempt Transaction.

In addition, appropriate selling or transfer restrictions will need to be printed on the actual issued instrument, typically global or jumbo certificate(s) in bold font if certificates are to be issued. However, Philippine company law does not require the physical issuance of certificates. PDEX also requires all its listing or enrollments to be dematerialized; hence, the lack of certificates means that no explicit selling restrictions will need to be printed.

If a bond or note is listed or enrolled on PDEX, as discussed in Chapter I, the observance of applicable selling and transfer restrictions is part of the explicit warranties that issuers and participants give to PDEX when signing up. Under the premise that an exemption from registration may be impaired if enrolled securities are held by non-Qualified Buyers, a set of conventions, controls, and processes are included within the PDEX operating framework that focus on the mitigation of the risk of transfers to non-Qualified Buyers and the resolution of situations when holdings of enrolled securities have been verified to be with non-Qualified Buyers. See also section G for information on issuances to Qualified Buyers and the nature of, or available exemptions from, registration.

There is no distinction between domestic issuers and nonresident issuers with regard to selling or transfer restrictions and their observance.

E. 19-Lender Rule and Its Applications

The so-called “19-lender rule” is unique to the Philippines and refers to a borrower not being able to borrow money from more than 19 lenders unless it has secured the requisite license with the BSP, if applicable. In the context of the bond market, an issuer cannot issue its debt securities to more than 19 investors without affecting its licensing status; the number of investors must not exceed 19 at any time during the lifecycle of the debt securities. The 19-lender rule is relevant only to certain non-bank financial institutions.

Relevance for Quasi-Banking License and BSP Supervision

The 19-lender limit was originally introduced by the BSP as one of the measures to regulate the relevant activities of so-called lending companies (granting direct loans to the public) as non-bank financial institutions. Non-bank financial institutions do not have a full banking license but facilitate banking-related financial services such as investment, risk pooling, contractual savings activities, and market brokering. The coverage of the 19-lender distinction was eventually extended to financing

companies—those companies engaged in, for example, leasing, factoring, and discounting—that carried out bank-like activities. The underlying objective is to regulate the activities of non-bank financial institutions performing functions similar to a bank (i.e., quasi-banking) such as deposit taking, raising funds, and consumer lending. Hence, the term “quasi-bank” can be found in BSP regulations and nomenclature. The term “non-bank quasi-bank” is also used.

Table 4: Quasi-Banking Consideration by Borrower Type

Borrower	Quasi-Banking Consideration	
	Status	Condition
Commercial company	No	Not under BSP supervision
Industrial company	No	Not under BSP supervision
Other nonfinancial company	No	Not under BSP supervision
Lending company	No	In case of normal activities under relevant regulations
	Yes	If 20 or more lenders (investors) at any one time
Financing company	No	Regular leasing, forfeiting, discounting exempt
	Yes	If 20 or more lenders (investors) at any one time

BSP = Bangko Sentral ng Pilipinas.
Source: ABMF SF1.

At present, all borrowing and debt-financing activities of lending and financing companies involving 20 or more lenders (investors) are regarded as quasi-banking (Table 4), pursuant to the so-called “Q Regulations” in the MORNBFI and, consequently, require a quasi-banking license from the BSP and are subject to BSP supervision. Under the Q Regulations, borrowing is defined as the issuance, endorsement, or acceptance of debt instruments of any kind other than deposits. Financing companies that do not require a quasi-banking license are generally supervised by the SEC and subject to the Financing Company Act, 1969, while lending companies are licensed by the municipality in which they operate and are subject to the provisions of the Lending Company Regulation Act, 2004.

The 19-lender limit has also been embedded in Section 10.1.(k) of the SRC. Potential non-bank financial institution issuers of AMBIF bonds are advised to consider the 19-lender rule carefully.

Recent Clarification of Deposit Substitutes and Impact on 19-Lender Rule

Republic Act No. 11211, which amended the New Central Bank Act (Republic Act No. 7653), also known as the BSP Charter, was signed into law on 14 February 2019. The amendment included a clarification of the definition of “deposit substitutes” that had a significant impact on the 19-lender rule.

When clarifying the phrase “obtaining funds from the public,” the term “lenders,” which is relevant for the rule of borrowing money from 20 or more lenders, was adjusted to not include financial intermediaries. For all intents and purposes, the constituents of the term “financial intermediaries” are eligible as Qualified Buyers. Hence, in accordance with the updated definition of deposit substitutes exempting financial intermediaries from the lender count, Qualified Buyers, as defined under Section 10.1 (I) of the SRC, that are financial intermediaries are excluded from the lender count for the purpose of the 19-lender rule.

Relevance as Criteria for Restricted Issuers and Restricted Securities

In the context of issuance and the listing or enrollment of debt securities on PDEX, Restricted Issuers are financial institutions without a quasi-banking license (hence, falling under BSP supervision) that must observe the 19-lender rule when issuing debt instruments lest they require a quasi-banking license.⁸ The restriction to issue to and maintain a maximum number of 19 investors (lenders) must be observed at all times during the tenor of the debt securities, notwithstanding the exception of financial intermediaries mentioned above. Such debt securities are, consequently, also known as Restricted Securities.

Pursuant to the PDEX Guidelines for Restricted Issuers and Non-Reporting Companies, which were issued as an addendum to the PDEX Enrollment Rules in October 2018, the terms Restricted Issuers and Restricted Securities only apply to issuers that issue or sell debt securities under an Exempt Transaction pursuant to Section 10.1 (I) of the SRC or SRC Rule 10.1.3, respectively, and which are limited only to Qualified Buyers. Such debt securities are also known as QB bonds. In fact, Restricted Securities represent a subset of QB bonds.

F. Note Issuance Program

AMBIF promotes the MTN program (or the note issuance program) format because it not only gives funding flexibility to issuers, but it also represents the most common format of bond issuance in the international bond market. This means that potential issuers as well as investors and intermediaries are likely to be familiar with the note issuance programs and related practices in ASEAN+3 markets. Hence, this would make AMBIF comparable to the relevant practices of the international bond market. At the same time, it is expected that potential issuers can benefit from reusing or adopting existing documentation and information disclosure. The SSF already supports multiple issuances.

As of August 2019, a framework for handling the listing or enrollment of bank-issued bonds issued under an “MTN-like” program had been approved by the PDEX Market Governance Board and submitted to the SEC for final approval. Since bank-issued bonds may have shorter tenors than medium-term notes, the framework was named the Bank Bond Issuance Program. The PDEX framework for listing or enrolling bank-issued bonds under this program essentially follows the same approach as for corporate bonds issued under an SEC-approved shelf registration.

While such a shelf-registration concept has been in existence for some time, it is not directly comparable to shelf-registration concepts typically practiced in other markets. The 2015 version of the SRC Rules, which represented the first major update of the original SRC Rules published in 2005, aimed to implement global and regional best practices while easing local regulations, particularly in the bond market. Among the many changes and refinements in the SRC Rules were the provisions to (i) make the

⁸ Under the SRC and its IRR, the count for the 19-lender limit of a non-quasi-bank issuer includes all holders of securities issued by the non-quasi-bank as well as all other direct lenders such as banks.

shelf-registration of debt securities easier, including a longer issuance period and faster time-to-market; and (ii) offer the ability to pay registration fees in line with multitranche issuances rather than pay upfront for the total issuance size. However, many of these concessions for shelf-registration refer to public offers.

G. Issuance to Qualified Buyers

The typical definition of a private placement is the issuance of bonds or notes to professional investors under exemptions or concessions from full disclosure or defined regulatory processes. There is no official mention or definition of private placement in law or regulations in the Philippines.

Instead, bonds or notes aimed at Qualified Buyers (QB bonds), or those classified as Exempt Transactions under the SRC, typically fulfill the traditional expectations of a private placement in which the target group is professional investors and the issue is subject to exemption from full disclosure under applicable regulations and, in the case of the Philippines, registration with and approval from the SEC. As such, the professional bond market in the Philippines consists of a combination of Exempt Securities and Exempt Transactions.

The IRR related to Section 10.1 (k), Subsection 10.1.2.4 of the SRC prescribe the restrictions for Exempt Transactions and stipulate that the following information be provided to potential investors:

- i. the exact name of the issuer and its predecessor, if any;
- ii. address of its principal executive offices;
- iii. place of incorporation;
- iv. exact title and class of the security;
- v. par or stated value of the security;
- vi. number of shares or total amount of securities outstanding at the end of the issuer's most recent fiscal year;
- vii. name and address of the transfer agent;
- viii. nature of the issuer's business;
- ix. nature of products or services offered;
- x. nature and extent of the issuer's facilities;
- xi. name of the chief executive officer and members of the board of directors;
- xii. issuer's most recent financial statements for the preceding 2 fiscal years or such period as the issuer (including its predecessor) has been in existence;
- xiii. whether the person offering or selling the securities is affiliated, directly or indirectly, with the issuer;
- xiv. whether the offering is being made directly or indirectly on behalf of the issuer, or any director, officer, or person who owns directly or indirectly more than 10% of the outstanding shares of any equity security of the issuer and, if so, the name of such person; and
- xv. information required under SRC Rule 10.1.1.

In cases where the issuer is a reporting company under Section 17 of the SRC, a copy of its most recent annual report (SEC Form 17-A) may be used to provide any of the required information.

H. Facility Agent

Under the PDEX Listing and Enrollment Rules (7.3.8), debt securities to be listed or enrolled on PDEX, including bank-issued bonds and commercial paper, must have a facility agent. The issuer needs to appoint the facility agent. The duties of a facility

agent include tasks normally associated with a bond trustee or bondholder representative.

The key functions of the facility agent under the PDEX Listing and Enrollment Rules are as follows:

- i. monitor the compliance of the issuer with all covenants of the issue;
- ii. act on behalf of the holders of securities in the event of any default of the issuer on any of the covenants; and
- iii. regularly report to the holders of the securities and to PDEX any of the following:
 - a. any change, impairment, or removal of deposited collateral;
 - b. acceleration of maturity of the issue;
 - c. any call for redemption;
 - d. noncompliance with sinking fund requirements, if any;
 - e. noncompliance with any covenant or condition of the issuer;
 - f. any event that will affect the obligations of the issuer under the issue; and
 - g. any other action of the issuer or other event that comes to the knowledge of the facility agent that may impair or affect the value of the security or instrument.

The PDEX Rules also stipulate that a facility agent should not have an interest in, or relation to, the issuer in order to be able to act as facility agent for the issuer.

I. Incentive for Longer-Tenored Issuances

Present tax regulations encourage the issuance of debt instruments (resembling in nature deposit substitutes) with a tenor in excess of 5 years and classified as a long-term deposit or investment certificate in order to achieve a favorable tax consideration for distributions from such debt instruments. In consequence, the market has adopted a practice of issuing bonds in the nature of deposit substitutes with a maturity of at least 5 years and 1 day to provide investors with this concession.

A proposal under Package 4 of the Tax Reform for Acceleration and Inclusion Act references that the tax exemption on the interest income of a long-term deposit or investment certificate with a tenor of more than 5 years be removed and replaced with a uniform final tax of 15% on interest income regardless of the tenor. At the time of compiling these Implementation Guidelines, Package 4 had not yet been approved by the Philippine Congress.

Through August 2019, no bank bonds had been issued with a tenor exceeding 5 years, as bank issuers might want to avoid the complications of having to change fiscal regimes following the expected passage of Package 4 of the Tax Reform for Acceleration and Inclusion Act.